Transcript for ECRS Phone Forum

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Moderator: Welcome to the EPCRS Phone Forum. At this time all participants are in a listen-only mode. As a reminder, today's conference is being recorded. I would now like to turn the conference over to your host, Mr. Mark O'Donnell.

M. O'Donnell: Hi, everyone. I'm Mark O'Donnell, the Director of Customer Education and Outreach for Employee Plans at the IRS. Thanks for dialing in to our phone forum today on the Employee Plans Compliance Resolution System. Today we're lucky to be hearing from Avaneesh Bhagat, Program Coordinator for the Employee Plans Voluntary Compliance program. I have personal appreciation of Avaneesh's expertise. His responsibilities include assisting with the resolution of applications made under the Voluntary Compliance program, assisting with the development of revenue procedure on the correction program, and responding to inquiries on plan corrections.

We will e-mail a certificate of completion to everyone who registers for this session and who attends the full session. Enrolled agents and enrolled retirement plan agents are entitled to continuing professional education credit for this session. For other tax professionals consult with your licensing organization to see if it provides continuing professional education credits for this session. The Retirement Plans' Web site at www.irs.gov/ep has lots of information on our correction program. You can also get there by going to the main IRS Web page, irs.gov and clicking on the Retirement Plans' community tab at the top. Once you're there, look to the left hand navigation bar for correcting plan error.

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So without further ado, here is Avaneesh Bhagat.

A. Bhagat: Hello, everybody. My name is Avaneesh Bhagat. I work as a program coordinator with Employee Plans Voluntary Compliance. The sequence I have planned in mind is first I hope you've all received a copy of the PowerPoint presentation that I'm going to refer to. What we'll do is we'll go through the slides in that PowerPoint, in that PowerPoint I try to incorporate some of the issues that people have concerns with. After that some of you were kind enough to submit issues that you're interested in hearing about and so we'll talk about some of those after we go through the PowerPoint. Then after that, if time permits, we'll have an open forum. So that's the sequence I have in mind.

Let's start with the PowerPoint. Slide one is just the title of the presentation, the "Employee Plans Compliance Resolution System." The second slide basically talks about our agenda for today. We're going to try—to the extent we can—provide you with an update on our revenue procedure and then get to the primary focus of the presentation, which is plan correction issues.

Now we're on to the third slide. We've received a lot of questions on when we might see the update to the current revenue procedure 2008-50. It's very, very tough to pin a time to it, primarily because a lot of the work on it is done; but as far as the clearance process goes many of our resources and counsel have been devoted to other priorities such as guidance on health care and other recent legislation. So it is very hard to assign a time to when that revenue procedure will be issued. You'll see in my slide I put sometime in 2010 question mark, but really it is very hard for me to give you an exact time frame.

The primary purpose of the expected update is to reflect the written plan requirement under the final 403(b) regulations. The structure of the programs remains the same. What you're familiar with in 2008-50 largely will carry forward to the subsequent revenue procedure.There will be some tweaks but the primary focus is to reflect the written plan requirement of the final 403(b) regulation.

So what does that mean? Basically once we get the new revenue procedure we will be able to address issues such as the failure to adopt the written plan by the end of 2009. And now that we have a written plan requirement the plan in operation has to operate in accordance with plan terms, so if you have a failure to operate the plan in accordance with plan terms you would be able to address that under the new revenue procedure.

Other 403(b) failures can be addressed under the current revenue procedure. So the follow up question you might ask is well, until that gets issued what should our approach be with respect to employers that have the failure to adopt a written plan in a timely fashion? What I would suggest is that if you know what the problem is and you know what the correction is, take that action. Don't wait on corrections until the program opens up. So, for example, if you have a situation where you have an employer that hasn't adopted a written plan program yet then adopt it, have the employer adopt it. Don't wait until the program opens up before that particular action is taken.

Let's go to the next slide. In revenue procedure 2008-50 we've requested comments of certain areas. A lot of times as rules change and things develop we don't have all the answers, and so what we do is we request comments on specific areas, but if you have comments on other areas of the revenue procedure as well we definitely invite those. You're not just limited to sending us comments on the areas that we request comments for.

In 2008-50 we requested comments on three areas. One is for 401(k) plans that provide for the automatic enrollment feature. One of the questions we had was whether the approach towards correction should change for an erroneously excluded employee because of the plan having an automatic enrollment feature. So do we have enough in our revenue procedure to correct and exclude an employee problem, or does the automatic enrollment feature change things?

The other one, and this has been an area where there's been a lot of questions and requests for guidance is in the context of Safe Harbor 401(k) plans, is there a standardized correction for the failure to provide Safe Harbor notice? Or is it a facts and circumstances determination where you would have to look at impact and then come up with a correction for that?

The final area where comments have been requested is in the area of designated Roth contributions. Basically the question goes along the following line, let's suppose your plan offers a Roth feature but in operation employees were allowed to make elective deferrals but were not allowed to designate all or a portion of those deferrals as Roth contributions as required by the terms of your plan. Now you find that problem after the fact a year or two later, what should the fix be? So we've asked for comments on that. The request for these comments will probably be renewed in the current revenue procedure as well. We've gotten a few, but not a lot of comments and so we're going to renew that request for comments in the new revenue procedure. There are a few ideas we have, and we'll talk about those a bit during the course of this presentation.

The next slide deals with the availability of EPCRS for 457 plans. As you're all aware, 457(b) plans generally, you can't address those within EPCRS. However, outside of EPCRS and in accordance with similar principles to EPCRS you could currently come in with proposals for correction of issues that impact 457(b) eligible governmental plans.

So then the question comes up as to what about problems that impact 457(b) plans sponsored by tax-exempt employers, and currently there's no program to address those plans either within or outside of EPCRS. Serious consideration is being given to loosen that requirement a little bit, where we may be able to address situations where the 457(b) plan is structured like a qualified plan and it is set up to benefit rank-and-file employees and you have problems associated with those types of plans. Those might be situations where either in the next revenue procedure or in a subsequent procedure that follows we may be able to address those. But currently we are limited to 457(b) eligible governmental plans. So that deals with our update for 457(b)'s.

Another area where we commonly get questions is the Department of Labor has a relief program for late or non-filers of 5500 returns. But then the question comes, what about 5500-EZs or those 5500s that do not fall under Department of Labor's jurisdiction because those plans are not subject to Title I of ERISA, so commonly that would be your 5500-EZ non-filers. And we're giving serious consideration to developing a program for that category of non-filers but it's still very much in the planning stages. But I just wanted to alert you that it's an issue that we are aware of and we're giving consideration to.

The next slide just basically summarizes the programs that we have, and those same programs will carry forward to the next revenue procedure update, the self-correction program, the voluntary correction program, and the audit closing agreement program. The first two are the voluntary pieces of the program in the sense that you, the employer would be basically initiating the correction. The self-correction program enables on to fix problems without IRS involvement. The voluntary correction program involves an application process to the service and the payment of a fee. The audit closing agreement program is a tool that's available to individuals who are examining plans and want to encourage correction of problems as an alternative to the severe sanction of disqualifying those plans.

All of these programs are designed with the goal of encouraging employers to fix problems and keep their plans qualified, thus preserving the tax favored benefits, the features of the retirement benefits provided to employees.

The next slide deals with correction principles. A lot of these correction principles are commonsensical. For example, full correction is required, full correction includes all years whether or not the taxable year is closed. Our goal is basically whatever correction method is devised we want to restore the plan and participants to the position they would have been in had the failure not occurred.

We wanted the corrections to be reasonable and appropriate and to facilitate that goal there are two tools available to you. One is there are Safe Harbor corrections in the appendices A and B of the revenue procedure. If you have a situation that falls within those appendices and you correct the problem as prescribed by those appendices you have deemed reliance, you don't even have to ask the IRS as to whether the correction works or not, so that's a really helpful tool, especially when you're doing self-correction and you don't have any affirmative guidance from the IRS as to whether the correction works or not.

The appendices A and B serve as a useful tool for that purpose. However, you're not limited to corrections using those appendices. You can follow the correction principles and devise a separate correction for failures identified in those appendices or other failures that are not listed in those appendices.

To determine whether the correction is reasonable or not you would look at the correction principles, and they have things like, for example, if you have choices, any correction that's designed to primarily provide benefits to non-highly compensated employees is the preferred alternative. You want to try to keep assets in the plan to the extent possible and you want to make sure that whatever correction you devise doesn't violate any other code requirements and is consistent with the code and regulations to the extent that it's possible to fashion a correction that will meet that goal.

So that's the background of the program and now we'll get into issues; issues both covered on these slides and that you've submitted for consideration. Let's look at self-correction. And here we have a scenario, where you have a violation of compensation limits under 401(a)(17). The failure occurred for six years and the question raised is whether the failure significant or not? Because the self-correction provisions in the revenue procedure are more like guidelines as opposed to prescribed rules per se you'd need to look at those guidelines and apply that analysis to figure out whether such a failure is eligible for self-correction or not.

The first thing you need to do is figure out whether the failure itself can be considered for self-correction. The only type of failure that you could address under self-correction is the failure to operate the plan in accordance with plan terms, so that if it's that type of a failure you could address that in the self-correction. By way of example, if you do not amend your plan timely for current laws or if you have demographic failure such as the failure of your plan to satisfy coverage or non-discrimination rules, those are the kinds of things that you couldn't address under self-correction. The focus of SCP is on the failure to operate the plan in accordance with plan terms.

Let's assume your plan has a 401(a)17 provision and you didn't comply with that, so that's an operational failure. Then the next step is you would look and see whether you have practices and procedures in place that would assist the plan in monitoring overall compliance with the code. If you don't have those in place then you can't consider your failure under the self-correction program. So those are the two things that you need to look at before you even get into whether your failure is significant or not.

After you get through that, then you evaluate the factors that would help you determine whether your failure is significant or insignificant. By way of background, the classification is important because insignificant failures can be corrected any time, even if your plan's under examination. Whereas, if it turns out that your failure is significant your plan can't be under examination and you generally have a two year time restriction from the time the failure occurred to fix it.

Given the importance of that you would evaluate the factors provided for in the revenue procedure. And it's a subjective evaluation. So when you evaluate those factors document the rationale and then ask yourself whether that's a rationale that you could use to convince an employee plans agent, if the plan came under audit, that your rationale works and therefore the correction was eligible for self-correction. Those are the key components of it. I'm not giving you a hard and fast answer because you would have to look at all the factors in totality.

For example, if you look at this particular failure, the fact that the failure occurred for six years probably weighs in favor of the fact that you have a significant failure. On the other hand, maybe the dollar amounts involved in relation to total plan assets, total plan contributions or something like that, there may be the amounts would be small, so that could be an offsetting factor. Therefore you would have to look at these factors as a whole and come up with an evaluation. So any time you call any of us coordinators and ask us, hey, can we use self-correction to do this, you're going to get one of those "I don't know" answers because really the guidelines are what they are and I'd be looking at the same guidance that you would be looking at. If you get to a situation where you're not sure that your rationale would work, then consider VCP as an option.

Also by way of information, let's suppose you fix the problem and you fix the problem appropriately and it turns out that the agent doesn't agree with you that the failure falls within the self-correction mechanism, the fact that you took steps to correct the problem would be a mitigating factor in determining what the amount of the audit cap sanction would be. So either way we want to encourage correction, and I think that should be the primary focus of how you approach things. Then the programs that they might fit in would be kind of secondary to that.

The next slide deals with the administrative practices requirement for self-correction. This one actually I took an extreme example, where just to illustrate the point, and here actually what the employer does is really favorable to participants and yet you can run afoul of the administrative practices rule, so let's consider this example.

Let's suppose you have a 401(k) profit sharing plan, and to keep things simple let's assume it has two pieces to it: an elective deferral piece and an employer contribution piece. So if you have those two pieces to it what a plan might do is say, okay, let the employee make elective deferrals and we will determine employer contributions without considering whether the employee made any elective deferrals at all. Then after we make the employer contribution, if those contributions plus whatever elective deferral contributions made on behalf of the participant cause the plan to violate 415, you would correct the problem by returning elective deferrals to the participant. So you would violate 415 on purpose and then correct the problem by returning elective deferrals to the participant.

The goal of this methodology is if you do it this way, even though you're violating 415 on purpose what you're doing is you're correcting the excess by returning elective deferrals and allowing the employee to keep a larger piece of the employer contributions. But when you do that you really don't have administrative practices to monitor compliance with the code, so really then you find yourself in a precarious situation where whether that correction then falls out of the parameters of self-correction, because you really don't have any practices and procedures to ensure compliance to the code. .

So the way that the revenue procedure is currently structured you would have to consider an alternative, where you would take into account elective deferrals and then adjust the profit sharing contributions at year-end to ensure compliance with 415. So here obviously the employee then doesn't get the benefit of preserving a larger piece of employer monies because the employer contributions are being adjusted up front to ensure compliance with 415. This is an extreme example where violating 415 and correcting later is favorable to the participant and we would still say that you don't have adequate administrative practices and procedures.

Now in most cases the failure to have adequate administrative practices and procedures is really detrimental to plan participants, but I purposely picked a weird case scenario to show you how important the administrative practices and procedures piece of it is, even in oddball situations such as this. This is an issue that has been drawn to our attention obviously, and it's something that in a future rev proc we might consider adjusting this administrative practices piece to take into account a situation like this one.

Shifting gears now, I'm just going to talk about different correction issues. There's not really any particular planned sequence, so let's look at the next issue. This was a common question that we get also, and that is, let's suppose the plan fails to file its determination letter application by the end of its scheduled cycle year, and a lot of times we get a question as to whether VCP is available to address the plan sponsor's failure to file an on cycle application. Our answer to that is no, because this is more of an administrative issue as opposed to a qualification issue. You're not violating any qualification rule by not filing a determination letter application by the end of its scheduled cycle year. It creates administrative inconveniences, yes, but it's not a qualification failure and so you wouldn't be able to address that under VCP.

Another common question we get is when is a determination letter submission required in the context of a VCP submission? The answer is two-fold. The first one is to address non-amender failures. When we talk about non-amender failures we're talking about the failure to amend for legislation by the end of the extended remedial amendment period. So we're not talking about, for example, things like interim amendments. If you didn't adopt interim amendments timely but the extended remedial amendment period for that legislation is still open you can correct that and you're not required to submit a determination letter application to fix that particular issue.

An exception to that (determination letter submission requirement for nonamenders) is made if you're fixing that problem by adopting a pre-approved plan document with a current opinion or advisory letter, or you're adopting an IRS model amendment to correct the problem. In that particular case, for purposes of our program we're not requesting a determination letter application submission because you're correcting the problem with using a plan document that's already been approved by the IRS. So we don't need a second determination letter application, to review the same provision. So non-amender failures where your fix is by the adoption of individually designed plans, require a determination letter application

The other situation would be where you're correcting operational problems or demographic problems by plan amendment and the submission is made during the plan's on cycle year. That would be a scenario where we would require a determination letter submission because the plan sponsor would typically be making a determination letter of submission anyway at that time. A determination letter application is not required in the case where interim or discretionary amendments are adopted using Appendix F schedule 1 or operational and demographic failures corrected by plan amendment in cases where the submission is made in off cycle years. Those are examples of situations where a determination letter submission is not required.

(Next slide) Plan amendment issues.. This is a common issue where let's say your plan is not amended for multiple pieces of legislation, for example, GUST and EGTRRA. A lot of times the question we get is can't you just adopt an EGTRRA document that's retroactive for all of the years in which the plan wasn't properly updated? The answer to that, even though it causes inconvenience, is generally no, because if you adopt an EGTRRA document that is retroactive for years that include years in which GUST was in effect, that document wouldn't really comply with qualification rules for the years in which GUST was in effect.

So a lot of times you would have to go through the effort of locating a GUST compliant document effective for the years in which GUST was in effect, and then have the employer adopt that and then layer it with an EGTRRA compliant document for years in which the EGTRRA provisions took effect. If you try to solve the problem with a single document it can be done but it creates a difficulty where you would have to have multiple provisions, both GUST provisions and EGTRRA provisions in there, with appropriate effective dates. So that's something that you would have to consider.

Another question we get on plan issues is as to when can you submit using Schedule 1 and take advantage of the $375 fee, and when do you need to submit using Schedule 2? And in that case if the plan can't take advantage of the $375 fee, when would the regular fee schedule apply. The general rule of thumb is, if you're correcting for interim amendments for which the employer didn't adopt interim amendments on a timely basis, but the extended remedial amendment period for those law changes is still open, then in that case you can take advantage of Appendix F, Schedule 1, which is a streamlined procedure for the failure to adopt interim amendments and take advantage of the $375 fee.

Otherwise if the extended remedial amendment period for that legislation for that particular plan has expired you have a non-amender problem and that non-amender problem then is subject to the regular fee schedule. Now, the only exception to that is if your extended remedial amendment period expires on a certain date and then you make a VCP submission proposing to correct that problem within a year of the expiration of that extended remedial amendment period, the plan can get a 50% discount on that fee schedule.

Now, shifting gears to operational issues, here we have an excluded employee problem where basically an employee was supposed to participate in the plan on April 1 but was actually provided with the opportunity to make deferrals on June 1 and upon entry the employee elects to defer 5% of compensation. Then the question is, can we assume that the employee would have elected to defer 5% of compensation for the period April 1 through May 31, that is the period of exclusion.

Generally the answer would be no, because we would not look at the elections made after the period of exclusion to estimate what a person would have deferred during the period of exclusion. Instead, the standard for correction is that you would use the average of the deferral elections of those who were allowed to participate in the plan and look at their deferrals and pick that average and use that as a proxy. That would be the general answer to that particular question.

The follow up to that since the employee was excluded for a very brief period of time could the employer take advantage of the brief period of exclusion rule in Appendix B- that that would put the employer off the hook in terms of making a contribution for the missed deferral opportunity. The answer to that question is no, the brief period of exclusion rule cannot be adapted to other situations. One of the requirements for a plan to take advantage of the brief period of exclusion rule is that there be at least nine months remaining in the plan year for the employee to make up elected deferrals so that he or she could make the maximum amount of deferrals allowable under the terms of the plan.

Here's one where we talk about the failure to provide notice in a Safe Harbor plan. In this scenario the question is, what should the fix be? And what this slide talks about generally is that we need to look at the impact because in some cases the failure to provide the Safe Harbor notice could result in effectively the erroneous exclusion of an eligible, in which case your approach towards correction would be something different than a situation where the employee was otherwise informed of the plan's features, was able to make elected deferrals, and in that scenario the correction might just involve revising practices and procedures going forward. That's the subjective piece of it and that basically is the problem for coming up with a standardized correction for the failure to provide the Safe Harbor notice.

This one deals with the automatic enrollment issue. What's the consequence if a plan fails to implement the plan's automatic enrollment provisions? This is one of the topics where we've asked for comments on, just like the Safe Harbor notice issue, and here actually there are a couple of interesting consequences depending on what the problem is. If your failure occurred because the eligible employee did not receive enrollment materials at all you effectively have the same problem as an excluded employee problem and therefore maybe your approach would be similar to the correction for an excluded employee in a 401(k) plan that doesn't have an automatic enrollment provision- you would determine your missed deferrals using ADP.

On the other hand, if you have a scenario where the employee actually received enrollment materials and then the employee did nothing and as a result of that basically has consented to the negative election, if you will, of having that automatic enrollment percentage contributed to the plan, and payroll messes up and just doesn't do the withholding, now you have a slightly different situation. Here you have a scenario where the plan in effect has not implemented the employee's negative election and you have a failure to implement an employee's election as opposed to a plain vanilla excluded employee problem. So in that case then you might use the automatic enrollment percentage instead of the ADP as a basis for figuring out what the missed deferral might be.

Defaulted loan issues - There's a correction principle in Section 6.02 of the revenue procedure where it says that in certain circumstances an employer contribution would be required and an employer contribution less than or equal to the interest that accumulates as a result of the failure. The additional interest would be the extent of the employer's liability if an employer contribution is required. A lot of times questions come up as to when could that situation possibly arise. In most cases the expectation is an employee takes a loan and the employee should be expected to pay it back. However, there could be situations where the failure by the employee to make payments is really caused by employer action that prevented such payments from occurring timely. That might be a situation where an employer contribution piece might be part of the correction proposal.

Also, you could have a situation where, the rate of return on plan investment exceeds the plan loan rate. So let's assume that the employee then is responsible for making delinquent payments on the loan, the employee would be responsible for making those delinquent payments based on the interest rate on the note. However, had those loan payments been made timely, those proceeds could have been reinvested to earn a higher rate of return if the plan's rate of return was higher than the plan's loan rate. So if your goal is to make the employee's account balance whole then there might be an additional piece- the excess of the return of plan investments over the plan loan rate- that the employer might be responsible for in order to make an employee's account balance whole.

So those could be examples of situations where employer payments might be warranted. Again, these are things to consider. There's no absolute hard and fast rule on these scenarios.

Let's suppose you have a scenario where your loan is in default and you're correcting under EPCRS through re-amortization. A lot of times the question is asked whether you could use an interest rate that's different than what the loan provides for. The general answer is, assuming the interest rate from the loan complied with plan terms and was reasonable at the time the loan was made, then any correction that you fashion would be made using the interest rate on the loan at the time the loan was made. What we don't want to do is encourage manipulation of the interest rate as part of the fix.

Shifting gears a bit, the next set of slides deals with the failure to suspend elected deferrals. Here, you have a situation where the participant receives a hardship distribution and the plan provides that the participant is prohibited from making elected deferrals for six months, but in operation the plan fails to suspend those deferrals. What's the correction for that? In order to get a handle on that one of the things that needs to be considered here is that , you have a plan provision that says that if a participant receives a hardship distribution then the deferrals for a period of time (typically six months) should be suspended. To the extent that they weren't suspended you have excess deferrals that were made to the plan and the most straightforward approach would be to return those excess deferrals to the participant.

Another issue that needs to be considered in terms of correction is usually when a plan has this type of provision it's relying on the Safe Harbor regulations with respect to hardship distributions. To the extent that you violate this rule your plan has fallen out of compliance with those Safe Harbor rules and the plan administrator then is stuck with the requirement of making a facts and circumstances determination as to whether distribution using plan funds was truly warranted to address that hardship need, because the regulations provide that. Generally, then all other sources of financing should be used before plan monies are dipped into. Basically when you don't comply with this rule you're falling afoul of the regulation's hardship safe harbor distribution requirement. That would buttress the argument for a correction where you may just want to return the excess deferrals for that six month period to the participant so that your plan's operation is then brought in compliance with the plan document requirement and the Safe Harbor rule. That would be the most straightforward approach.

Sometimes a plan sponsor could suggest an option where instead of returning the elected deferrals, the plan would suspend those elected deferrals for a six month period going forward. That could possibly work, however, you need to consider different things when fashioning your approach toward correction. One of which would be that if you decide to implement that suspension prospectively remember that at that point in time the matching contribution rates could be different and the plan conditions could be different, such that the cost to the participant when he suspends deferrals going forward could be different from what would have occurred if the suspension occurred during the period in which the deferrals should have been suspended. So that's one thing that you would need to consider when fashioning a correction.

Also, what would you do if you implement this prospective correction and the employee leaves before the expiration of the six month period? You would need to figure out what your correction would be under that particular scenario. These are things that you may want to consider when taking this approach.

The final option a lot of times is that the employer proposes to take no action and to revise administrative procedures going forward. The general answer would be that we wouldn't like that approach simply because you're not really correcting the problem when you do that. That participant still has excess elected deferrals sitting in this plan account. There might be some circumstances where maybe it's not feasible to secure a correction and the plan has no choice but to make prospective changes to the administrative procedures. That might be a situation where that option is considered, but really consider that as a last resort because you're not correcting the problem when taking that approach.

Shifting gears again, this one relates to the use of forfeitures to make corrective QNCs. The question is, can a plan use forfeitures to make qualified non-elective contributions for correcting a failed ADP test? In the past we've been guilty of allowing the use of forfeitures, especially in plans where the plan provides that the forfeitures are used to reduce employer contributions.

Let's suppose your plan fails the ADP test and an employer contribution is required to fix it, we in the past used to say, well, since the plan provides that forfeitures are used to reduce employer contribution requirements why not use the forfeitures as a source of funding of the qualified non-elective contribution. As long as at the time the money hits the participant's that the participant is fully vested we should be good. The employee's been made whole and you're complying with the requirements of the ADP test.

However, it was later on pointed out to us that if we take that approach we're violating a regulation because if you look at the regulations for the definition of qualified non-elective contribution it basically says that the qualified non-elective contribution should come from non-elective contributions that satisfy the vesting and the distribution requirements in the 401(k) at the time the contribution was made to the plan. Since generally forfeitures are derived from contributions that were not fully vested when made, forfeitures cannot be used to satisfy that QNC requirement to correct a failed ADP test without violating a regulation.

One of the correction principles is that you don't want to implement one fix that causes a violation of another code or regulation requirement. So basically our stand is, after being made aware of this regulation, is that for purposes of correcting a failed ADP test if you're using QNC to fix it, the monies for the QNCs can't come from forfeitures.

Now, to make an area of distinction, though, and by the way, that clarification will also be made in the next revenue procedure -if you have an excluded employee problem and you want to use forfeitures to fund the QNCs required to replace the missed deferral opportunity of an excluded employee, there because that's more of a revenue procedure fix as opposed to a regulation required fix, we would permit the use of forfeitures to provide for the employer contributions required to correct an excluded employee problem. So, no for the correction of the ADP test; yes for correction of the excluded employee problem.

That takes care of the presentation piece, the PowerPoint piece of the presentation. What I want to do now is shift gears towards the issues that were submitted over the course of time through today by attendees. I have taken the liberty of, in many cases, shortening the questions or combining a bunch of questions received from different sources into, in particular a shorter question if I could in the interest of time. So let's get to those and hopefully between what was in the presentation and the issues I'm going to cover now it addresses all the concerns you might have.

Let's deal with program related questions first. The first question I'm going to talk about is can a VCP filer exclude plan failures that occurred many years ago, failures that relate to closed tax years, if they are unrelated to very recent failures that are being disclosed? Remember now, the scope of your compliance statement is only as good as the failures that you identify for correction. So basically if you make a submission that only identifies failures that relate to open plan years, for example, then those are the failures that we would address and your compliance statement would provide you coverage for those particular failures.

So if you take that approach, then to the extent that uncorrected failures for older years have an impact on the qualified status of a plan for open plan years, you have exposure for the failures that originate in those old plan years because your compliance statement does not address those failures. When you're taking that approach just keep that in mind as to what kind of coverage do you want from the compliance statement. Your compliance statement is only as good as the failures you identify for correction and then the approached correction with respect to those failures. Anything that you don't identify is not covered by the compliance statement.

Next question- Under revenue procedure 2008-50 in order to do a retroactive amendment under self-correction what is the IRS determination letter filing procedure if a plan is on a pre-approved prototype document? As we discussed before, if you're correcting a problem using a pre-approved document, and your amendment doesn't result in the plan becoming an individually designed plan, then in that case you don't need to submit a determination letter application. You just adopt the amendment using the prototype framework and you should be fine. The separate filing would only be required in situations where your plan sponsor is using an individually designed plan and would generally be making a determination letter application with respect to that plan on the scheduled cycle year. .

When does a VCP filing need to include a determination filing in an off cycle plan year? In an off cycle plan year the only time a VCP filing would be required is if the plan sponsor is correcting a non-amender failure and the correction is being accomplished by the adoption of an individually designed plan. We covered this area earlier in the presentation, so I guess I should probably shift gears and move on.

In terms of tools let me provide you some helpful hints here in dealing with the non-amender question because we're getting so many questions on these. In addition to the revenue procedure there are a couple of articles and memorandums that are on the IRS Web site that you can take a look at. The first article is entitled, "Non-Amender Failures and the Voluntary Correction Program." You can find that link to the article on the Web site entitled "Correcting Plan Errors" which can be found after accessing the Retirement Plans Community tab at www.irs.gov. A simple alternative would be just to type "Non-amender failures and the Voluntary Correction Program" in your search engine and when you get to your search results, you'd look at an item with the IRS web site that addresses that topic. Chances are you'll hit that article.

You can also look at an article entitled, "Corrective Amendments to Pre-Approved Plans," this is a good article, it's a memorandum that was issued by the director of employee plans on March 11, 2009. So if you typed into your search engine "Corrective amendments to Pre-approved plans" and if you wanted to add some parameters you could say "issued by Michael Julianelle, Director, Employee Plans, March 11, 2009," but I think even if you had that topic there in your search engine it should provide you a link to the IRS Web site that has that particular article.

The memorandum actually provides for very useful information where there could be situations where in the normal course if you amend your plan to correct a problem it could throw your pre-approved plan out of pre-approved status and would cause it to become an individually designed plan. However, the memorandum provides for scenarios where relief from that result might be warranted, and so in that case your plan doesn't lose its pre-approved plan status even when you're adopting that corrective amendment. So that's a very useful memorandum to look at.

Will a procedure be made available for correcting a volume submitter or a prototype plan that lists the April 30, 2010 deadline? You don't need any new procedure. The current revenue procedure can be used for this purpose. If the streamlined procedure is being used you can use Appendix F, Schedule 2. For the description of the failure, fill in the box under "Other." In that box you could put something like "The failure by the plan sponsor to re-state its pre-approved plan ... by the April 30, 2010 deadline." So you can address that failure now. You don't have to wait for any new procedure to be issued for this.

It's a non-amender failure because the extended remedial letter appeared in the pre-approved framework for amending your plan for it to expire in April 30, 2010. So this is not akin to an interim amendment problem, this is a non-amender problem. The fee schedule applies. However, if you make your VCP submission within a year of the April 30, 2010 deadline, so basically by April 30, 2011, you can get a 50% discount of the regular fee schedule.

There's also, for reference, an article that we just published in a recent issue of *Retirement News for Employers*, so if you go to the IRS Web site and into the Retirement Plans Community and you go into Newsletters you can find the *Retirement News for Employers* Summer 2010 edition. And it actually addresses two situations: the failure to timely adopt the document by April 30, 2010, and that's a VCP issue and they even have a VCP submission kit that you could piggyback off of for purposes of preparing a VCP submission for this particular failure; and then it also addresses another issue which is kind of more on the determination letter side for plans that are taking advantage of the 5307 determination letter program. If you have a situation where your document was adopted timely but the plan did not submit for its 5307 determination letter application by April 30, 2010, what procedures apply to that, you can take a look at that article and see what procedures should be applied there. Again, *Retirement News for Employers* Summer 2010 edition.

Next question, the good faith amendment for the Pension Protection Act of 2006 was not adopted by the end of the 2009 plan year. So what schedule would you follow and do you use the $375 fee or does a regular fee apply? The answer depends on what the plan cycle is. So, for example, if your plan is an individually designed plan and is under Cycle D, the plan should have been restated for PPA by the end of its cycle on January 31, 2010. So for Cycle D plans if you haven't restated your plan for PPA by that deadline you have a non-amender problem and the regular fee schedule applies.

But alternatively, if you have a plan that's, for example, on Cycle A, the plan would be restated to incorporate PPA by the end of its cycle on January 31, 2012. In such a case PPA is really an interim amendment issue and if the interim amendment wasn't adopted by the end of 2009, you can submit a VCP application to address the failure to timely adopt the PPA and from an amendment using Appendix F, Schedule 1. And if that's the only failure you're correcting for the $375 fee would apply. So really what you need to determine is do you have a non-amender issue or a simple failure to adopt the interim amendment. And that depends on what the plan's cycle is.

Operational issues, and one of the major categories that gets impacted a lot is the failure by a plan to operate in accordance with the definition of compensation in the plan document. So there are a couple of questions that have come in for this particular issue. The first one is, if the employee used an incorrect definition of compensation to calculate the deferral of a participant's salary and if the client could use the correct definition it would result in additional deferrals, so what's the correction? For the deferral piece your objective is to replace the missed deferral opportunity.

So, for example, let's suppose the plan provides that you could make deferrals from bonuses but in operation the deferrals from bonuses were not permitted, the employee has a missed deferral opportunity with respect to the bonus piece of compensation and your corrective contribution would be equal to 50% of the missed deferrals adjusted for earnings. Because here the employee is not out the money, the employee received the bonus but the employee was deprived of the opportunity to have a portion of those deferrals deferred to the 401(k) plan. So the contribution requirement would be the 50% instead of 100% of the missed deferrals. Now, if there was a related match the employee would of course be entitled to the full match.

So now piggybacking off of the missed deferral piece, we have a little bit more of a complex question, and this one is as follows. So just focus with me on it a little bit because it's a little bit lengthy. The question is: From the time the plan was first adopted the employer's intentions were to permit participants to make a separate deferral election on bonuses that are awarded throughout the year, including the option to have no elected deferral applied to the bonus payment. So a person who did not complete a deferral election with respect to bonuses would have had no deferrals made with respect to bonuses. The adoption agreement, however, was incorrectly completed to provide that a participant did not have an option to a separate deferral election for bonuses. It provided for a single election that's applied to all categories of compensation.

The result is, let's suppose you have an employee in a situation where he completes a single election form. If you follow the plan terms that election would be applied to all categories of compensation including bonuses. Whereas, the way the plan was operated it required a separate election form for the bonus piece, so therefore that original election form was not being applied towards the bonus piece of compensation unless there was a separate election form for the bonus piece. So you have a difference between intent and what the document provides.

Now, the series of questions comes into play. Could the problem be resolved with the plan sponsor adopting an amendment to mirror employer intent? The default answer to this question would be if the amendment could cause a cutback in what the employee could get, the answer is no. So in situations where your plan actually provides that your deferral election extends to all categories of compensation, you would be amending the plan to say no it doesn't and you need a separate election in order to have the bonus piece incorporated into the compensation considered for elected deferral. You're providing for a cutback, so in general the amendment would not be allowed.

Then the question is, well, are there any situations at all where we would allow such an amendment? In limited situations if the employer can show through other evidence that this was an obvious drafting mistake then the service might be considered, but the burden of proof is on the employer to demonstrate that. What kind of documents are required? There's no hard and fast rule on that. Every situation is different. You have to weigh the facts and circumstances and the documentation that you actually have that would prove the employer intent and what the expectations of the employees might be. So in generic terms documentation of employer decisions, communications to employees, would be a critical component in demonstrating that.

Assuming that you couldn't prove intent or you just don't want to go that route, what would the general correction be? The general correction would be that you would use the employee's election form to determine the deferral that should have been made from all categories of compensation, including bonuses. So in appropriate situations where that election wasn't applied to the bonus piece, corrective contribution equal to 50% of the missed deferral attributable to bonuses would be required, plus any additional match.

So it's a long-winded discussion of a problem, but it's a problem that comes off and on as to when can we use retroactive amendments to fix problems and is that really a viable alternative to a dollar fix. The general answer is going to be no. If the plan terms require that an employee get a certain benefit you can just cut that back through a plan amendment. So that's the summary of this entire analysis.

Shifting gears now to ADP corrections, we'll talk about the one-to-one QNC correction. There's a series of questions that come into play for that. The first one is, when calculating the amount of a QNC using the one-to-one correction can you consider both positive and negative earnings? The short answer to that is yes.

When using the one-to-one correction method can you have situations where the methodology results in the employee's getting de minimis amounts and so really practically you might want to come up with a somewhat different approach to allocate the QNC that's used to correct the ADP test using the one-to-one correction method? The answer is probably you could. You may want to consider the exceptions to full correction provided in Section 6.02 of the revenue procedure, and that includes a provision relating to the delivery of small benefits. That provision might support the rationale you might use in coming up with an approach that the revenue procedure might otherwise consider to be less than full correction.

Again on the one-to-one correction approach, a question comes as to whether if your plan was tested using permissive disaggregation, refunds were made timely but later on it was found that correct data was used to run the test could you then apply permissive disaggregation to determine the corrective contribution using the one-to-one approach? Generally, the revenue procedure does not permit the use of disaggregation to determine the refund and corrective contribution amount. So you're coming up with a correction that's a departure from the standardized approach in the revenue procedure. This would be a very good candidate in the context of a VCP submission, where you would be arguing for a correction alternative to the Safe Harbor correction provided in the appendices.

Could you use that different approach under SCP? That's a decision you would have to make. It depends, because now you're using an approach that's outside of the safe harbor provided for in the revenue procedure, so you don't have specific revenue procedure provisions to back you up and if the plan was being examined you would basically need to convince the agent that the correction approach was reasonable and satisfied the correction principles. So if you thought that it was reasonable and it met that criteria and you were comfortable with that, then use SCP, but just know that you're taking somewhat of a risk because you don't have a specific revenue procedure item to hang your hat on. You're just relying on a reasonable interpretation of correction principles.

Similarly, there's a provision where you have an excluded employee problem ,the question is can you rely on existing ADP testing? The revenue procedure has a safe harbor that says that if you excluded a group of employees and your ADP tests were run using employees who were not erroneously excluded from the plan, That is correct for the excluded employee problem and you should be okay. (there is no need to re run ADP test)

So then the issue comes up, well, what if your ADP and ACP tests were conducted somewhat differently? For example, if you actually included those erroneously excluded employees in your test but used zeros, could you just rely on that ADP test? Probably, you might be able to, because arguably I guess if that revenue procedure provision wasn't there and the plan excluded employees, they (the excluded employees) didn't make deferrals, so when you run your test prior to correction you would have those erroneously excluded employees as part of your test and their deferrals would be at zero. Having said that, if you take that approach, you couldn't use that diluted ADP number as a basis for figuring out your corrective contribution on behalf of excluded employees.

And again, these are judgment call issues because you don't have a specific revenue procedure provision to hang your hat on. So generally the approach would be, outside of the excluded employee failure, does the plan have a reasonable basis to rely on that test? If so, maybe you could just rely on that test and not have to re-run it. Otherwise you might want to consider looking at a revenue procedure provision.

Then another variation is what about if you use the corrective contribution for your excluded employees and include that in your ADP testing? Here, you have a couple of problems because first the revenue procedure requires that the excluded employee problem cannot be addressed before evaluating compliance with ADP/ACP test so you would have to look at that first, fix that before you address the excluded employee problem.

Secondly, the use of QNCs in those two scenarios is different. In the ADP/ACP testing context a dollar for QNC counts as a dollar of deferrals; whereas, in the excluded employee context a dollar in QNC replaces two dollars in missed deferral opportunities. So that variation is a bit more complicated.

Shifting gears to the delivery of small benefits, the question is, can the delivery of small benefits exceptions be used in situations where a former participant in a defined contribution plan no longer has an account balance under the plan and is owed the corrective allocation that under the terms of the plan would immediately and automatically be distributed to the affected participant? What this is alluding to is a situation where you can use the small benefits exception for the distribution piece, but for corrective contributions there's no small dollar threshold for corrective contributions. However, in this particular situation it's probably a reasonable approach to extend that provision to corrective contributions, because if you apply the provisions of the rev proc and we say that you would have to make a corrective contribution to the plan, then you could apply the exception for delivery of small benefits and the result would be that money would never get to the participant that it was intended for.

So in such a situation an argument could be made that a contribution would not be required because that money would never reach a participant's hands anyway. So, I think if you have a situation where the corrective contribution is linked to distribution that would otherwise never reach that participant, you could probably make an argument that the corrective contribution would not be required.

The next category of issues deals with broadly improper distributions, and we'll illustrate one scenario but really it could be anything. Here you have a situation where the distribution was made to an employee because it was thought that the employee terminated employment with the employer. However, it turns out that the employee did not sever from employment and the employee simply transferred from one employer in the control group to another. So really what you have is a distribution that was made from an employee's account balance in violation of plan terms.

What causes confusion in this area often is that a distribution that's made in violation of plan terms falls within the revenue procedure's definition of overpayments, which generally deals with the erroneous distribution of excess amounts to a participant. So within the overpayment correction you have two issues: one, that distributions that were made from an employee's account balance in violation of plan terms; and another, which is the more common one, a distribution made to an employee that was in excess of what an employee was entitled to under the terms of the plan.

Under both of those scenarios, whether it's a distribution from account balance in violation of plan terms or an excess amount distributed to the participant, you would take the following step. The employer would make a reasonable attempt to recover amounts distributed. The employer would in effect notify the employee of the erroneous distribution and ask for the money back. It would also inform the employee that unreturned monies are not eligible for tax favored treatment such as a rollover to an IRA.

However, there is a distinction, though. If you have an erroneous distribution made from a participant's account attempting to recover monies from the participant is fine, but the employer wouldn't be required to make a corrective contribution to the plan to replenish amounts that weren't returned by the employee because the employee would get a windfall. That correction piece is generally limited to situations where excess amounts were distributed to an employee which would in effect have an impact on what other employees are entitled to. In that case the employer would then be expected to replenish the plan for unrecovered monies so that other affected employees could get what they're rightfully entitled to.

That provision is not really very clear in the revenue procedure so oftentimes when you have a situation where an improper distribution is made from an employee's account that question often comes up, is the employer stuck with making corrective contributions to the plan to the extent that the employer's not successful in recovering monies from the employee? The answer to that is no, because you don't want to create a windfall situation for that employee.

Loan problems, this one basically says that you have a situation where a plan made what it thought was a principal residence loan and later finds out that it wasn't and therefore the repayment terms could not have been longer than five years. So the loan was for a longer term, because it was thought that the loan was for the acquisition of a principal residence, but later on finds out that wasn't the case. So the question is, what correction procedure would be used to fix the problem? If the correction involves re-amortizing the note going forward so that the loan is fully paid off within the five year period, then the plan could propose that correction and correct the problem under VCP and the loan would be treated as if it always complied with the section 72(p) rule.

If on the other hand the plan doesn't want to correct this problem by re-amortizing the notes that are fully paid off within the five year period, then the loan in effect is a deemed distribution for 72(p) purposes. The deemed distribution occurred at the time the loan was actually made to the participant, because at that point in time you have a loan that was made for a period that was longer than the five year period and so you, at that point in time, have a deemed distribution to the participant. In that case the only thing that the VCP procedure would be useful for is possibly postponing the recognition of that amount, the deemed distribution income from the year of the failure, which was the year in which the loan was made, to the year in which the failure is discovered and the VCP submission is made. So that would be the only practical use of that revenue procedure.

Piggybacking off of this, let's suppose now we're dealing with loan issues and assuming one has a submission where you're correcting missed loan payments by either make up payments or re-amortization for that the loan is fully paid off within the five year period, a question arises as to which program should one use, EPCRS or the DOL voluntary fiduciary program? Both programs have separate objectives. You would use EPCRS if your goal was to get, for example, 72(p) relief. Only EPCRS could get you that relief. If your goal was to get relief from penalties that result from fiduciary violations, then you would use the Department of Labor program.

So let's suppose you have a loan with both a 72(p) violation and also a fiduciary violation and you wanted to get both the 72(p) relief and relief from fiduciary penalties, generally you would need to use both programs and you would sequentially correct the 72(p) problem first with EPCRS. And then as part of your submission to the DOL program you would submit the compliance statement issued to fix the 72(p) violation as part of your proof of correction in your submission to the DOL program. So you would use both programs and you would use VCP first before using the Department of Labor's program. Hopefully that addresses the applicability of programs and the sequence in which they would probably be applied.

Moving out from the area of qualified plans, we're going to deal with SIMPLEs and SEP IRAs for a minute. Here we have an issue as to how are excess contributions handled using EPCRS for SIMPLE and SEP IRAs? The short answer is that you would look at Section 6.10 of revenue procedure 2008-50, and if you look at it, you will find that the correction principles in many ways are very similar to what you would do for the qualified plan world with just some little twists. So if your excess amount is attributable to elected deferrals then the answer is that the excess elected deferrals are returned with earnings to the participant and with respect to those excess deferrals the participant is not eligible for favorable tax treatment with respect to those deferrals that were returned to the employee. The same principle just like you would for qualified plans.

What about employer contributions? In a qualified plan if an employee receives excess employer contributions you could solve the problem by a forfeiture of those excess employer contributions. In Simple IRAs and SEPs the money actually goes into an IRA, so in many cases when that happens the employee is now in control of that money. The employee then would be expected to return the money from the SEP or Simple IRA (the excess employer contribution) to the employer. From a reporting standpoint, if the money is actually returned by the plan to the employer—

W: Pardon the interruption. Two minutes are remaining.

A. Bhagat: Okay, I have a couple of minutes left. So then this will be our final answer. Then you would have distribution of those monies to the employer and the distribution will be reported on the 1009R issued to the participant indicating that the taxable amount of the participant is zero. That would be the reporting requirement for that. In some cases you have an excess amount that just is not returned by the SEP or simple IRA and in that case the revenue procedure provides for an additional fee which is at least 10% of the excess amount that's sitting in the IRA in addition to the normal VCP submission fee. So you could probably in that limited situation leave the excess amount in there but pay a higher VCP submission fee.

With that, I've run out of time. I apologize that I don't have the chance to do an open forum, but I think we covered quite a few questions today. So I hope you found the presentation useful. Thank you.

Moderator: That does conclude our conference for today. Thank you for your participation and for using AT&T TeleConference Service. You may now disconnect.